

Written Testimony of
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Introduction

Chairman Davis, Ranking Member Waxman and members of the Committee, thank you for inviting me to testify today. I am Terri Shaw, the Department of Education's Chief Operating Officer for Federal Student Aid, a position I have held since September 2002. I am pleased to be here representing Secretary Spellings, the Department and the very talented and dedicated Federal Student Aid team to discuss the administration of the Federal student financial assistance programs in general, and the Federal Family Education Loan (FFEL) and William D. Ford Federal Direct Loan (Direct Loan) programs in particular.

I am also especially pleased to discuss initiatives that resulted in two significant accomplishments of the Department and Federal Student Aid – the recent attainment of a green status on the President's Management Agenda Scorecard for Elimination of Fraud and Error in the Student Aid Programs and Deficiencies in Financial Management and the removal, this past January, of the student aid programs from the Government Accountability Office's list of High-Risk programs.

The Department of Education's grant, loan, and work programs represent the largest source of student aid for postsecondary education in the United States. In 2004, these programs provided approximately \$69 billion to more than ten million students and their families.

Work and Responsibilities of Federal Student Aid

Federal Student Aid is charged with operational responsibility for oversight and administration of all the Department's Federal student financial assistance programs under Title IV of the Higher Education Act of 1965 (HEA) and, as one of the government's few Performance-Based Organizations, upholds high standards of operational efficiency, innovation and customer care.

The Higher Education Amendments of 1998 established Federal Student Aid, under the Direction of the Secretary, as the Federal Government's first Performance-Based Organization, with particular emphasis on modernizing the delivery of the Federal student assistance programs. The authorizing statute provides that the purposes of the Performance-Based Organization are to:

- increase accountability;
- improve service to students;
- integrate information systems;
- implement a common integrated delivery system;
- strengthen program integrity; and
- reduce costs of administering the programs.

To carry out these purposes, Federal Student Aid is focused on:

- delivering world-class customer service;
- developing award-winning products and services;
- effectively managing the programs to ensure fair, effective and appropriate oversight; and
- service delivery at the lowest cost without sacrificing service levels or quality.

I want to share with the Committee some statistics that illustrate the size and scope of the Department's Federal student aid enterprise. The Department's Federal Student Aid office ensures the availability and accessibility of the Free Application for Federal Student Aid (FAFSA) to students and parents and receives and processes FAFSAs for over 14 million aid applicants each year. We have dramatically transformed the aid application process from a 100 percent paper process to one that is now nearly 90 percent web-based.

The Department's Federal Student Aid office is the single largest originator of student loans, annually making over three million Direct Loans totaling nearly \$13 billion to two million student and parent borrowers. Each year, we originate over 300,000 Direct Consolidation Loans totaling \$7 billion. We service the \$87 billion outstanding loan portfolio of 18 million Direct Loans made to more than seven million borrowers. We are responsible for collection on \$17 billion of defaulted student loans, including Direct Loans, FFEL and Perkins Loans. We oversee the approximately \$390 billion outstanding student loan portfolio, including loans held by lenders, guaranty agencies, and schools. The Department provides over \$12 billion in Federal Pell Grants to five million undergraduate students each year. Our systems process millions of financial and other transactions annually and our websites receive 20 billion hits each year. We handle more than 40 million inbound and outbound phone calls through our customer care centers. And each year we send more than 41 million pieces of mail to aid applicants and borrowers.

Federal Student Aid contracts with a number of private sector providers for our major business functions, including application processing, disbursement and payment processing, customer call center operations, data center operations, and default portfolio collections. Federal Student Aid staff manages and monitors these contracts and the service delivery provided. Our contracting of business processing is a practice used by others in the higher education funding community, including many lenders and servicers in the FFEL Program. In fact, we contract with some of the same providers that FFEL lenders use. Federal Student Aid's contracts total \$500 million annually and employ an estimated 6,000 contract staff, located throughout the United States. I should note that we have created innovative contract solutions to optimize the investment of taxpayer dollars and the return on that investment. For example, our contracts with private collection agencies have performance-based evaluation incentives. This resulted in an increase of defaulted loan recoveries from \$670 million to \$1.25 billion over a four-year period while collection costs were reduced from 18 percent to 16 percent – a decrease of 11 percent.

Federal Student Aid is also responsible for providing outreach services and materials to students, schools, families, and community agencies. We provide training, both in-person and, increasingly web-based, and technical support for our delivery partners. We also create and distribute a number of publications designed to remind, inform, and instruct students and their families.

Fair and effective oversight and monitoring of the approximately 6,000 institutions of higher education that participate in the programs is also one of Federal Student Aid's core responsibilities, as is our oversight of the nearly 3,500 lenders, guaranty agencies, and servicers that participate in the FFEL Program.

Our oversight activities include real-time, and near real-time, quality control. We have built into our systems and processes edits, triggers, risk assessments and other features that enable us and our partners to monitor and correct errors; and to provide early warnings of potential trouble. In addition, we monitor our school and lending community delivery partners by reviewing required annual compliance audits and financial statements, performing on-site program reviews, and analyzing partner-specific data to detect trends and areas that could be of concern.

We are particularly proud of the Department's and Federal Student Aid's recent achievement of a major President's Management Agenda (PMA), Government Accountability Office (GAO) and departmental objective by reducing the vulnerability of the Federal student aid programs to fraud, waste, abuse and mismanagement. As a result of the Department's specific focus on reducing these vulnerabilities, in January of 2005, GAO removed the Federal student aid programs from its High-Risk list. The student aid programs were placed on the High-Risk list when the list was created in 1990. Additionally, the PMA Scorecard for Elimination of Fraud and Error in Student Aid Programs and Deficiencies in Financial Management achieved "all green" on status and progress on March 31, 2005. In your hearing invitation you asked me to highlight some of the initiatives that resulted in these achievements.

Simply stated, the Department and Federal Student Aid made reducing vulnerabilities in the programs and the removal of the student aid programs from the High-Risk list a top priority. We

developed very specific action plans and regularly monitored our progress. We held all levels of management and staff accountable for accomplishing the tasks specified in the action plans.

We institutionalized sound financial management and received clean audit opinions in Fiscal Years 2002, 2003, and 2004 with no material weaknesses in Fiscal Years 2003 and 2004.

Federal Student Aid also focused on student loan default prevention and management through default prevention strategies implemented by participants across the programs. The combined FFEL and Direct Loan cohort default rate was reduced from an all-time high of 22.4 percent in Fiscal Year 1990 to an all-time low of 5.2 percent for Fiscal Year 2002, a dramatic 77 percent reduction.

Federal Student Aid engages in an ongoing process of actively identifying risks in the programs. Noncompliance with statutes, regulations and policies by schools, lenders, guaranty agencies, and servicers not only places Title IV funds at risk, but erodes the public trust in the programs. We have several initiatives underway, including a joint task force with the Department's Office of the Inspector General, to identify real or potential risks for fraud, waste, abuse and mismanagement in the programs. Federal Student Aid also established an Enterprise Risk Management unit to better coordinate risk monitoring and action plans among our various business units and with other Department of Education offices.

We developed a multiyear sequencing plan for system and business process integration, completing several of the scheduled initiatives and are continuing to make significant progress on future deliverables. We are integrating and reengineering many of our existing systems and functions. Our two principal initiatives are "ADvance", an integration of our front-end business processes of aid awareness, application processing, origination and disbursement, web services, and customer service; and "Common Services for Borrowers" (CSB), our integrated processes of Direct Loan servicing, Direct Loan consolidation and default collection. The innovative contracting solutions for ADvance and CSB could save taxpayers an estimated \$500 million and \$1 billion, respectively, over the possible ten-year terms of these contracts. Continued

investment in system integration projects, such as ADvance and CSB, is required to ensure these projected savings.

As I mentioned, the financial aid application process has been transformed from 100 percent paper to nearly 90 percent electronic. In fact, electronic processing has been implemented in all phases of the financial aid process. From learning about student aid and the advantages of a postsecondary education by accessing web-based materials, through the application process, to electronically signing promissory notes and the disbursement of funds, and finally to the repayment of loans; students can successfully manage their financial aid lifecycle without ever seeing or handling a piece of paper. This is accomplished through a series of secure, user-friendly, and efficient electronic processes that have simplified the financial aid process for students and families. And, of course, we also have eliminated virtually all paper in our financial aid and data transactions with our delivery partners: schools, lenders, guaranty agencies, and servicers.

Our most recent customer satisfaction scores for our electronic FAFSA, as measured by the American Customer Satisfaction Index (ASCI), were comparable to UPS, Mercedes Benz, and Amazon.com. Similarly, our scores for our Direct Loan Servicing operation were better than for Wachovia Bank and similar financial services entities and our customer satisfaction scores for Pell Grant and Direct Loan origination and disbursement surpass the scores received by E-Trade.

We also implemented a comprehensive and strategic human capital management plan. The plan provides a detailed roadmap for addressing Federal Student Aid's critical workforce issues, including leadership development and succession planning. As part of this plan, we aligned individual staff performance plans, including those for Federal Student Aid's senior officials, to the accomplishment of our strategic objectives.

Federal Student Aid is realizing efficiencies, productivity gain, and capital savings through our many initiatives enabling us to manage significantly increasing workloads, at lower marginal operating costs. For example, for Fiscal Years 2002 – 2004, the number of FAFSA applications,

Direct Loan borrowers, collection accounts, and Pell Grant recipients increased 11 percent, 8 percent, 4.5 percent, and 18 percent, respectively.

While we are justifiably proud of the Department's and Federal Student Aid's accomplishments over the past several years, we understand that the focus, attention, and accountability that led to these achievements should always have been in place. It should not be a newsworthy event that clean financial audits are received or that the student aid programs are not on the GAO High-Risk list. We are supposed to get clean audits and we are supposed to exercise proper oversight and management of the programs.

FFEL and Direct Loan Programs

As you know, there are three Federal student loan programs, the smallest of which is the campus-run, Federal Perkins Loan Program. The two larger programs, and the ones this hearing is focused on, are the FFEL and Direct Loan Programs. While there are two programs, there is but a single mission and a common goal – to ensure that low and middle-income students and their families can afford the costs of postsecondary education. Both programs have the same eligibility requirements and provide the same annual and aggregate borrowing limits. Loans in both programs have essentially the same terms, conditions, and benefits to borrowers, including deferments, forbearances, and repayment options.

The delivery and funding models, however, are different. Under the Direct Loan Program, the Federal Government is the lender with loan funds provided directly from the Federal Treasury. The borrower repays directly to the Federal Government. The Federal Government, with support from FSA's private contractors, performs all collection activities on defaulted loans and assumes the risk of default, interest rate fluctuations, and discharges.

Under the FFEL Program, private financial institutions are the lenders and use their own funds to make loans. Borrowers repay directly to the private lender, or its agent. The private lenders perform all servicing activities. State and not-for-profit guaranty agencies perform collection activities on defaulted loans. Through a series of reimbursements and interest benefits, the

Federal Government assumes virtually all of the risk of default, interest rate fluctuations, and discharges for the FFEL Program, much the same as for Direct Loans.

Annually, about \$13 billion in loans are made to nearly two million Direct Loan borrowers and about \$39 billion in loans are made to over five million FFEL borrowers. Additionally, each year nearly \$8 billion in Direct Consolidation Loans are made to over 300,000 borrowers and \$36 billion in FFEL Consolidation Loans are made to over one million borrowers. At the end of Fiscal Year 2004, the outstanding Direct Loan portfolio was \$87 billion and the outstanding FFEL portfolio was almost \$260 billion: 25 percent and 75 percent, respectively, of the combined \$347 billion non-defaulted outstanding portfolio.

There are many participants in the two programs. There are over 1,000 institutions of higher education that participate in the Direct Loan Program, and as I previously mentioned, the Department is both the lender and the servicer. In the FFEL Program there are about 5,000 institutions and nearly 3,500 lenders, servicers, and State and private non-profit guaranty agencies that insure the lender against default and obtain reimbursement by the Federal Government.

What is most critical, I think, to this discussion is the role that Federal Student Aid plays in the administration and oversight of these two loan programs. Federal Student Aid is the discrete management unit, reporting to the Secretary, responsible for managing the operations and functions supporting these programs as well as the other Title IV programs.

As a Performance-Based Organization, our job is pretty clear: deliver world-class customer service; develop award-winning products and services; effectively manage the programs to ensure fair, effective, and appropriate oversight; and provide service delivery at the lowest cost without sacrificing service levels or quality.

The Department is committed to ensuring the integrity and viability of both the FFEL and Direct Loan programs. The availability of choice has made both programs stronger through competition, has been the catalyst for innovation, has forced standardization of data exchange

methods and, most importantly, has appropriately directed the focus on service to students and parents, and to the institutions of higher education that are on the front-lines serving them.

Your invitation asked me to suggest recommendations for legislative changes needed to improve the management of the Federal student loan programs. As a Performance-Based Organization, Federal Student Aid is granted by Congress certain limited managerial flexibilities over our budget, procurement, and human capital management activities. We are aggressive in using these flexibilities to meet our objectives and we will continue to explore additional flexibilities that we can take advantage of under current law. I believe that in order for Federal Student Aid to be most effective, it must be able to operate more like a private-sector business than as a traditional government agency – fully aware, however, of our special responsibilities to taxpayers, employees, and our business partners.

In addition, changes may also be necessary in the Performance-Based Organization authorizing legislation. The Department is in the process of developing its legislative recommendations for the upcoming reauthorization of the Higher Education Act. We intend to work closely with the authorizing committees as we consider possible changes to the statutory language for the Performance-Based Organization. Any changes related to human capital management will complement the Administration's government-wide civil service reforms announced in the FY 2006 President's Budget.

With respect to the programs themselves and our operational and administrative responsibilities, I would like to highlight a legislative proposal that the Administration has supported for several years, and is included in the President's Fiscal Year 2006 Budget: an amendment to section 6103 of the Internal Revenue Code that would allow for the matching of student aid application data with IRS tax information. We believe that, if this change is enacted, we could eliminate many burdensome processes that are currently used to verify student aid applicant data, and further simplify the process for applicants, their families, and schools. Additionally, we could significantly reduce student aid improper payments due to inaccurately reported income by applicants. Reducing these improper payments could lead to significant cost savings of approximately \$300 million annually in the Federal Pell Grant Program.

There is, of course, no lack of student aid simplification proposals under consideration both within and outside of government as the Congress approaches reauthorization of the HEA. We in Federal Student Aid monitor many of those discussions and, when appropriate, offer our comments and suggestions. I believe that your colleagues on the authorizing committees will be looking at these proposals and we are, of course, ready to provide whatever analytical and programmatic support that is needed.

I am honored to be part of Secretary Spellings' team and the Department of Education, an organization that plays such a central and essential role in our Nation. Federal Student Aid ensures that all eligible Americans can benefit from federally funded financial assistance for education beyond high school and we consistently champion the promise of postsecondary education for all Americans – and its value to our society.

On behalf of the Secretary, the Department and the Federal Student Aid staff, thank you for the opportunity to share with you our performance and accomplishments.

I am pleased to answer any questions you may have.